No. 24—January-February 1959

Business in Brief

issued bi-monthly by the Economic Research Department

THE CHASE MANHATTAN BANK

Business activity has regained its previous high. Gross national product reached a record $453 billion rate in the fourth quarter. After adjustment for rising prices, over-all activity matched the level of the third quarter of 1957, making this the shortest postwar recession.

However, ours is a growth economy. To meet the many demands pressing on the nation at home and abroad, we need to do more than regain past peaks. Actually, the economy has the potential to produce as much as $35 billion more than is now being turned out —and this ability to produce grows almost $20 billion per annum.

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What factors will determine the extent to which we realize this productive potential in the period ahead? Up to now the major forces making for recovery have been increases at annual rates of:

$ 8.5 billion in inventory buying;

$ 6.5 billion in government expenditures on goods and services;

$ 2.4 billion in housing; and

$10.3 billion in consumption, with an 8% rise in consumer durables in the fourth quarter.

From now on the upward impetus from the first three of these factors will begin to lose force.

¶ A normal rate of inventory buying at the level of sales in prospect would be no more than about $4 billion.

¶ New housing starts have topped the 1.4 million rate, about as high a level as might be sustained by basic demand and the flow of mortgage funds.

¶ Government expenditures may continue to increase, but the rate of advance promises to slow down.

In all, these three areas could be less than half as potent in the year ahead as they have been so far.

What, then, could support a continued vigorous expansion? Three questions dominate the outlook:

¶ **Will business investment in new plant and equipment move ahead?** Preliminary surveys point to no more than a moderate rise in this crucial area. Yet a continued rise in sales could lift the operating rate in many industries close to capacity and generate a new wave of expansion. Earnings promise to be sufficient to support such an increase in capital investment as the year progresses.

¶ **Will consumer purchases of durable goods display continued strength?** Sales of consumer hard goods picked up in the fourth quarter. But it is still too soon to determine definitely how consumers will react to the 1959 autos and other durables.

¶ **Will exports move up?** They turned up recently, following a 20% drop from their peak in early 1957.

A full-fledged expansion in business and a return to capacity operations by the end of the year would require developing strength in the above areas. Most observers are taking a conservative view of prospects in these fields. Yet enough strength could develop to keep business moving ahead at a good pace.

In that event, how to contain inflationary pressures could again become the number one domestic economic problem. To cope with inflation, it would be necessary to secure public support of policies leading to an eventual surplus in the federal budget, tight credit and restraint on the wage-price front.

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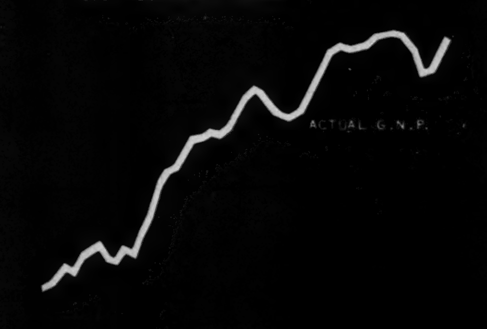
Vigorous economic growth and general price stability are essential first steps if the nation is to measure up to the challenges it confronts. Thus, efforts to keep the rise in wage rates and the growth in purchasing power within the limits that can be maintained without pushing prices up deserve broad public support.

NATIONAL OUTPUT STILL BELOW ITS POSTWAR TREND

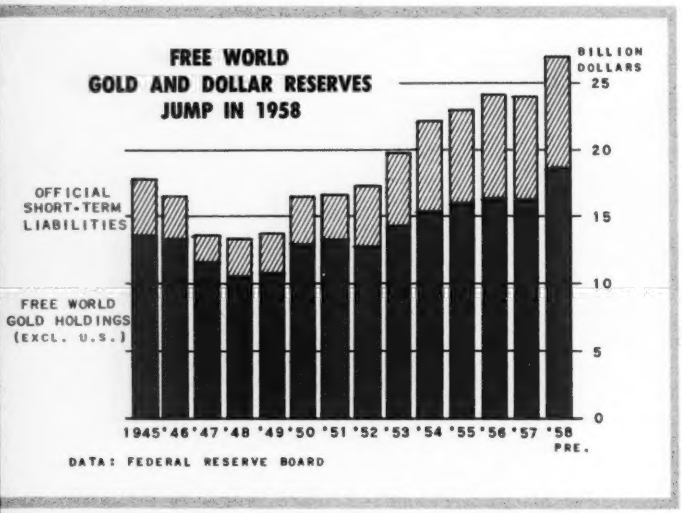


A NEW PHASE IN WORLD TRADE

One of the major postwar problems, the notorious dollar shortage, seems to be disappearing, at least in a number of countries. In December eleven Western European nations established limited currency convertibility. This means that nonresidents who receive payments in any of these currencies through regular commercial transactions are free to exchange the proceeds for any other currency, including dollars.

This move is acknowledged as the beginning of more complete reform, with the long-run aim of full convertibility and the eventual elimination of all dollar restrictions. It suggests a welcome degree of self-confidence of the European governments to manage their affairs in a way consistent with maximum freedom and growth in foreign trade. And it is of importance to U.S. business:

- It simplifies many of the procedures formerly necessary to transfer currencies between countries and thus facilitates multilateral trade relationships.
- It is likely to broaden U.S. sales possibilities in countries having favorable payments balances with Europe. Such countries may now more easily use their European balances to make dollar purchases.



The Problem for the U.S.

Despite the approval with which this move has been received in the United States, it has brought into focus a question that has disquieted many thoughtful businessmen: Does the growing strength of European currencies reflect a corresponding weakness of the dollar?

The move toward convertibility in Western Europe does reflect a strengthening of its competitive position in world markets. This has been accompanied by a great deal of discussion here and abroad as to the future position of the dollar. This discussion has sought to answer such questions as: Is the U.S. pricing itself out of world markets? What do recent shifts in world trade patterns imply for future confidence in the dollar?

As is usually the case in such matters, no certain answers can be provided. Yet it may be useful to review the record to see why concern has shifted so abruptly from the dollar shortage to a potential dollar surplus.

Two sets of forces have been at work: first, short-run factors relating to the Suez crisis and the business cycle pattern in the U.S. and Western Europe; and second, longer-term trends in the World economy. Both sets of factors need to be examined in attempting to judge future trends in U.S. exports and imports.

Short-Term Factors

U.S. exports were pushed to unusually high levels in late 1956 and early 1957 for two reasons. **First,** the closing of Suez added substantially to the demand for U.S. petroleum and coal, and swelled U.S. exports during late 1956 and 1957. **Second,** and more important, many foreign countries were undergoing a pronounced investment boom, creating especially heavy demands for U.S. capital goods and raw materials exports. The result of these two factors was a bulge in U.S. exports in 1957.

As the investment activity abroad passed its peak and oil shipments through Suez were resumed, exports fell sharply. Meanwhile, although the U.S. was undergoing a recession, imports dropped only moderately. As a result, the U.S. trade balance was drastically reduced, and it became possible for foreign central banks to accumulate dollar assets or gold much more rapidly than during previous periods: shipments of U.S. gold amounted to about $2.3 billion, and dollar assets held by foreigners rose approximately $1 billion during 1958.

In the process, many U.S. exporters ran into intense competition from foreign suppliers. As excess capacity developed abroad, competitors in such countries as Germany, Japan, and Switzerland cut prices in a number of cases. This has helped them to capture a larger share of the reduced world markets during 1958 despite the fact that U.S. export prices did not rise on the average during the year.

More intense competition for foreign markets during periods of slackened world demand is not unusual. History suggests that a revival of world demand in response to a renewed advance in business activity could lead to a pick-up in U.S. exports.

The Long-Run Problem

At the same time, long-term trends indicate a basic change in the atmosphere in which U.S. exporters may have to operate. To appreciate this, it is helpful to see the problem in historical perspective.

The period since the end of World War II can be divided into three well-defined phases—two in the past and a third we are now entering.

PHASE I: After World War II, demand for U.S. exports was intense. The low level of production abroad at relatively high costs, fixed exchange rates in the face of rapid

inflation, and large government purchases for development and reconstruction purposes placed heavy pressure on the available dollars of most countries. Though the U.S. government provided substantial aid, few countries could obtain all the dollars they required at existing rates of exchange. The result was a rapid decline in gold and dollar holdings outside the U.S.

By the middle of 1949 it was clear that a major readjustment in exchange rates was unavoidable. In the autumn the U.K. and most other countries outside the Dollar Area devalued their currencies by an average of 30%. This raised the price of U.S. goods to foreign importers sharply. In fact, it reduced the price advantage of the U.S. to a level below that in 1946. And it marked the end of Phase I.

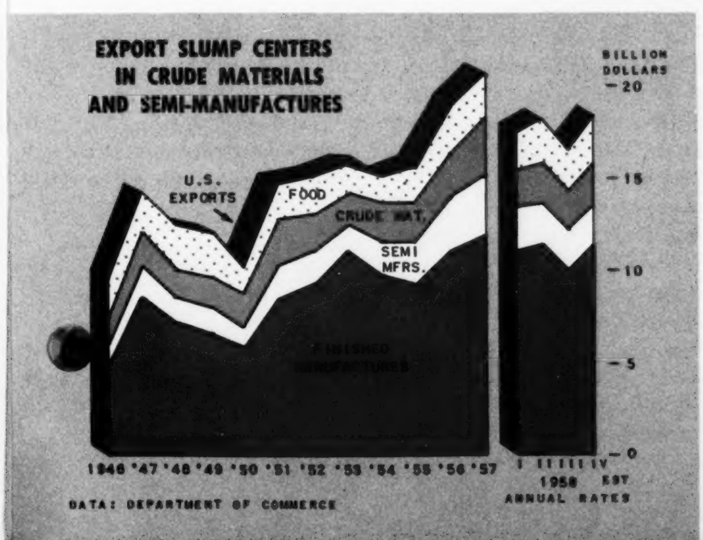
Phase II: After the devaluation of 1949, inflation abroad began to restore the price advantage of the U.S. exporter. Nevertheless, foreign reserves began to pick up. The following year saw the beginning of the Korean conflict, leading to a sharp increase in U.S. demand for imports and a substantial rise in U.S. prices.

Foreign holdings of gold and dollars rose rapidly in 1951. While there was a slight leveling of these holdings in late 1951 and early 1952, the advance from that time until the Suez crisis was continuous and substantial. From 1949 through 1957, foreign gold and dollar holdings increased an average of $1.6 billion per year.

During this phase a few countries relaxed certain restrictions against the dollar, particularly countries like Germany and Japan, where non-inflationary monetary policy and rapid growth laid the basis for a strong export sector. In many countries, however, inflation resulted in tighter restrictions than before.

Nevertheless, in several key areas gold and dollar reserves were reaching adequate levels. The turning point, marking the end of Phase II, came in 1958 with the drop in U.S. exports.

Phase III: This phase is now formally opened with the announcement of partial convertibility in Europe, and the promise of greater exchange liberalization later on. While it is impossible to predict the shape of the next few years, the position of the U.S. in the world



economy is likely to be altered significantly.

First, monetary and fiscal policies will be affected. While the monetary authorities have acted to restrain inflation in the past, they have done so for reasons having little to do with the U.S. balance of payments. So long as prices abroad rose as fast or faster than those in the U.S., there was little need for concern in this sphere.

But this period is at an end. The prospect for the future is for more stable monetary conditions in other countries, and perhaps greater readiness to devalue if this should prove necessary. Hence the effect of inflation on the cost of U.S. exports—and the attractiveness of imports—will have to be considered as an additional penalty for inadequate controls against inflation.

However, regardless of what happens to U.S. prices, competition from abroad will be more vigorous. Our trading competitors, apart from controlling their own inflations, have been investing in modern plant and equipment; they have adopted many of our techniques; and they have the capacity to handle a larger share of the world market than in earlier years.

If on top of this the U.S. should undergo further inflation relative to the rest of the world, many U.S. goods would be quickly priced out of world markets. In that event, the present short-run trade problem facing the U.S. could be converted into a crisis of confidence in the dollar, which would have much more serious repercussions.

However, the U.S. can maintain a strong position if steps are taken to deal effectively with inflation, and if we can maintain a rapid rate of technological advance.

It is important that this be done, not only because exports are of significance to U.S. business, but because stability of the dollar and expansion of world trade are essential to the welfare of the Free World.

RECENT TRENDS IN THE CREDIT MARKETS

A more stable atmosphere returned to the money markets over the final months of 1958. Interest rates have held within a fairly narrow range since last September, after spiraling close to their postwar highs during the summer. Meanwhile, the market has successfully absorbed a rising volume of credit demands—generated in large part by the current Federal deficit.

Shifting Demands for Bank Credit

The ability of the market to meet the increased financing needs of Government and other borrowers without serious new strains has been dependent, in considerable part, on funds made available by commercial banks.

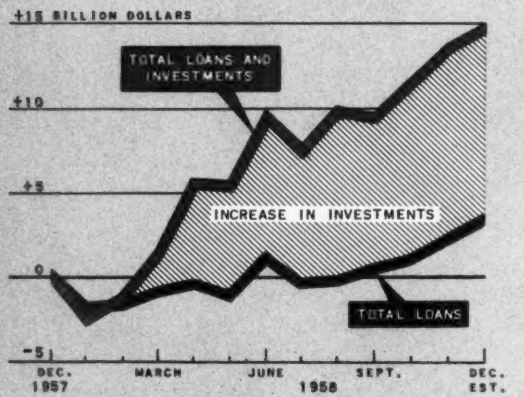
- Business loans turned higher after July, rising by $1.8 billion at weekly reporting banks alone over the last five months of the year. Nearly all of that increase reflects normal seasonal influences. But the recent trend contrasts sharply with experience during the same period of 1957, when declining business activity limited the "seasonal" increase to only $500 million dollars.

- Reporting banks added $700 million to their mortgage portfolios over the second half of 1958—close to a record amount for a six month period. This step-up in purchases of mortgages by banks provided important support for that area of the capital market, and thus for the homebuilding industry.

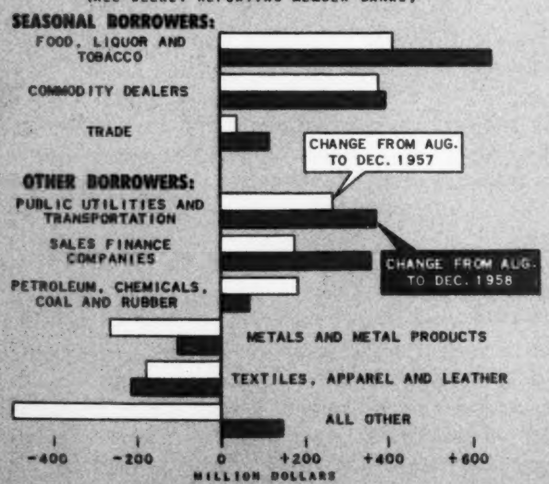
As a result of these demands, total commercial bank loans approached a new peak of $98 billion at the end of 1958, roughly 4% above the previous year.

The rising loan volume, combined with a less ample supply of reserves, required that banks limit their new investments over the second half of 1958. Purchases of state and local government securities, which ran at a record pace during the early months of the year, were sharply curtailed. Moreover, net acquisitions of U.S. Government securities were substantially less than the $6.5 billion added to portfolios in the first six months of 1958.

TOTAL BANK CREDIT IS RISING...
(ALL COMMERCIAL BANKS)



BUT BUSINESS LOAN DEMAND IS MOSTLY SEASONAL
(ALL WEEKLY REPORTING MEMBER BANKS)



DATA: FEDERAL RESERVE BOARD

Further Growth in the Money Supply

The recent growth in bank credit produced a sharp increase in commercial bank deposits toward the end of the year. Consequently, the money supply (currency and demand deposits), after leveling off in the summer, rose to a new peak of $138.5 billion by the end of November, 3.3% above year ago levels.

This monetary expansion does not, in itself, suggest that the economy is becoming overly liquid and, as a result, vulnerable to inflationary pressures. An additional increase in the money supply may well be appropriate to support further recovery. In that connection, the money supply is still significantly smaller, relative to the level of business activity, than in the comparable stages of other postwar business recoveries.

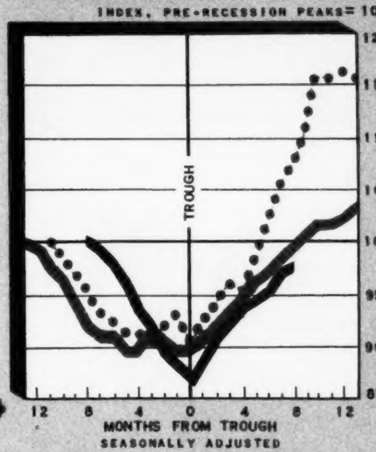
Federal Reserve Policy

The Federal Reserve has been sensitive to the threat of undue reliance on bank credit as the economy expands. Thus, the authorities did not supply, by means of open market purchases or reductions in reserve requirements, all the funds necessary to support the deposit increase toward the end of 1958. Instead, member banks found it necessary to borrow from their Reserve banks with increasing frequency—an important symptom of growing restraint on the banking system.

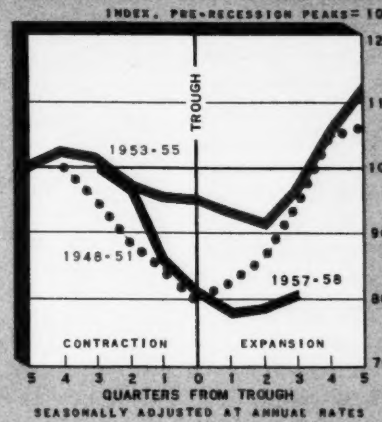
The Federal Reserve has ample power to carry restraint to the point of forestalling a rise of inflationary proportions in bank credit and deposits. But achieving that goal, while at the same time assuring a supply of credit adequate to support economic growth and to meet the needs of the Treasury, promises to be one of the major challenges facing the economy in 1959.

POSTWAR RECESSIONS IN PROFILE

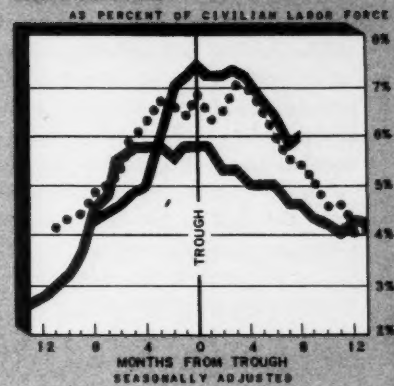
INDUSTRIAL PRODUCTION



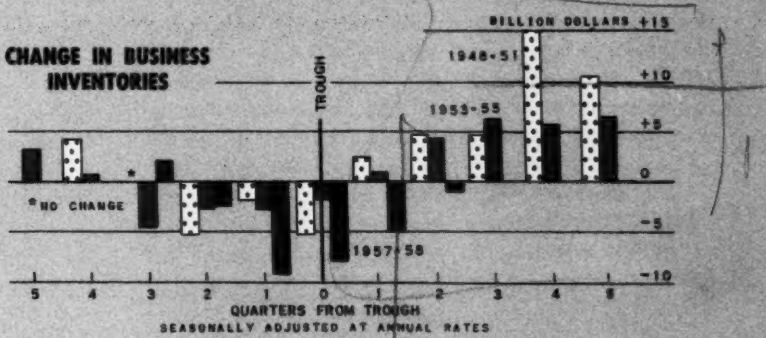
PLANT AND EQUIPMENT EXPENDITURES



UNEMPLOYMENT



CHANGE IN BUSINESS INVENTORIES



The accompanying charts show how various economic series acted during the three postwar recessions and recoveries.

Each series begins at the previous business peak and at an index of 100 (except unemployment and inventory change, where actual figures are used). The trough designates the general business low. The high or low of individual economic series does not always coincide with the business peak or trough.

The recession dates are:

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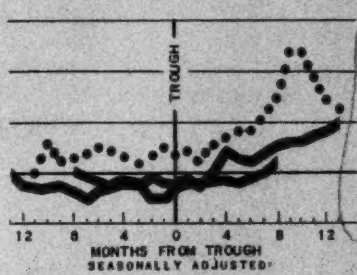

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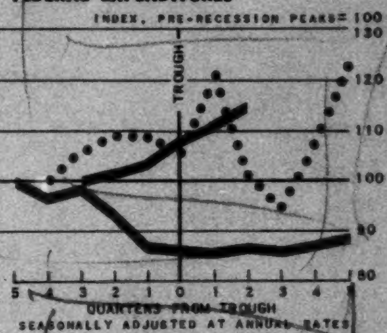
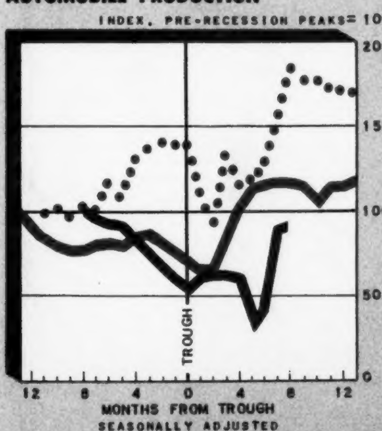
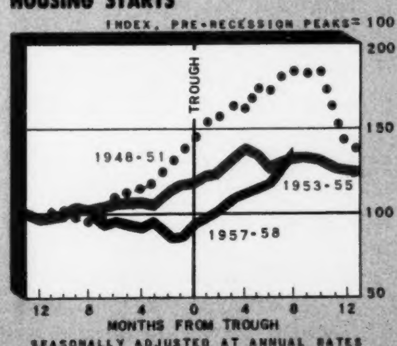


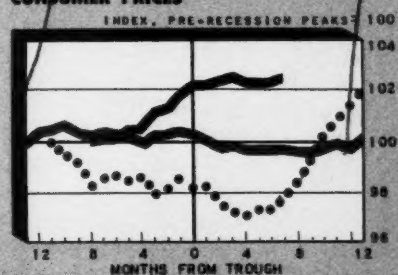
AUTOMOBILE PRODUCTION



HOUSING STARTS



CONSUMER PRICES



DATA: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR AND FEDERAL RESERVE BOARD

CHARTS PATTERNED AFTER SCORECARD OF RECESSION AND RECOVERY, COMMITTEE FOR ECONOMIC DEVELOPMENT

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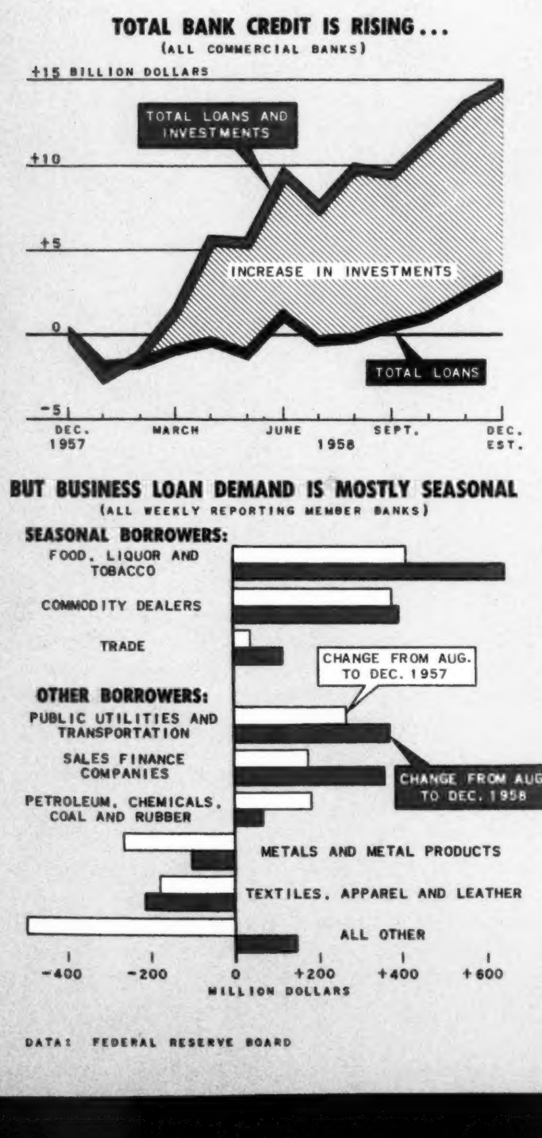

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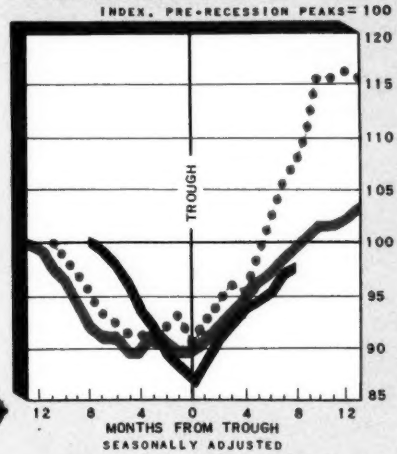

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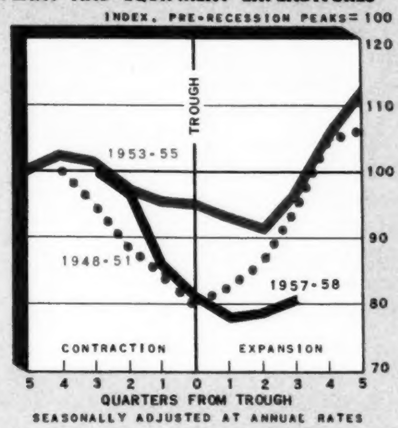

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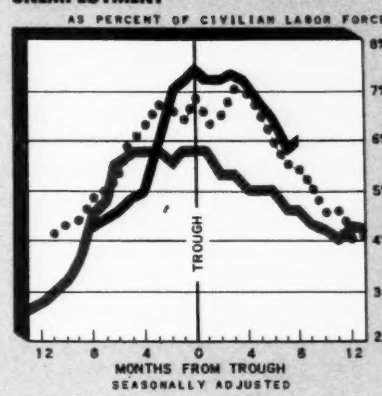

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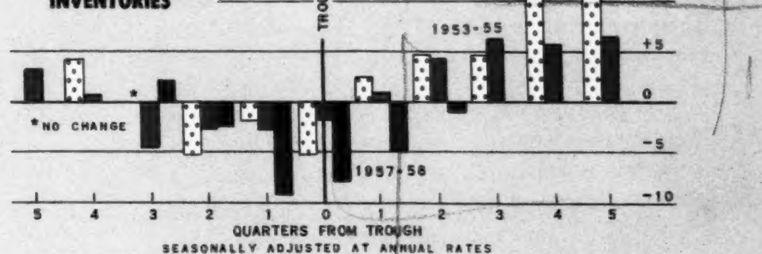

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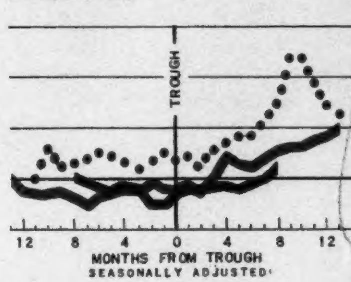
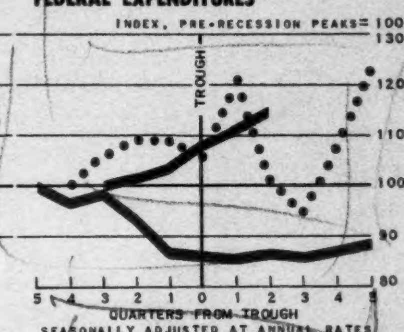
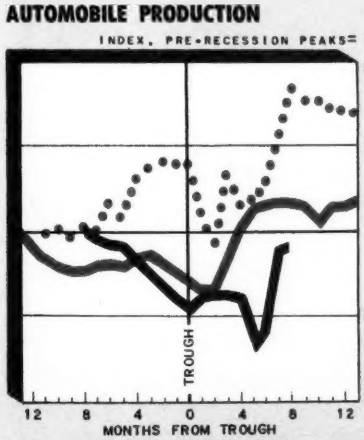


FEDERAL EXPENDITURES



AUTOMOBILE PRODUCTION



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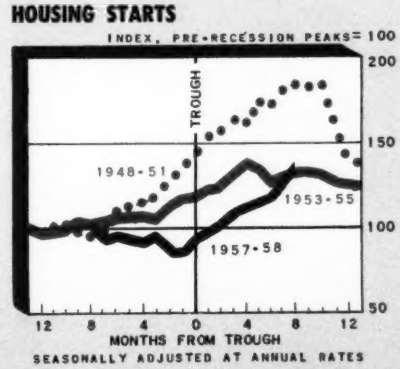
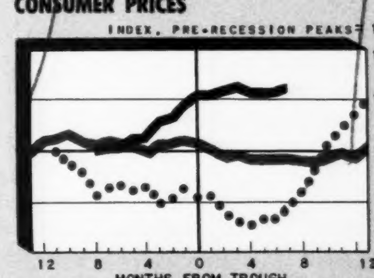


CONSUMER PRICES



DATA: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR AND FEDERAL RESERVE BOARD
CHARTS PATTERNED AFTER SCORECARD OF RECESSION AND RECOVERY, COMMITTEE FOR ECONOMIC DEVELOPMENT

CORPORATE EARNINGS

Corporate earnings have staged an encouraging comeback after taking the deepest dip of the postwar period. Following a drop of more than one-fourth during the downward phase of the recession, earnings have by now recovered almost all their lost ground.

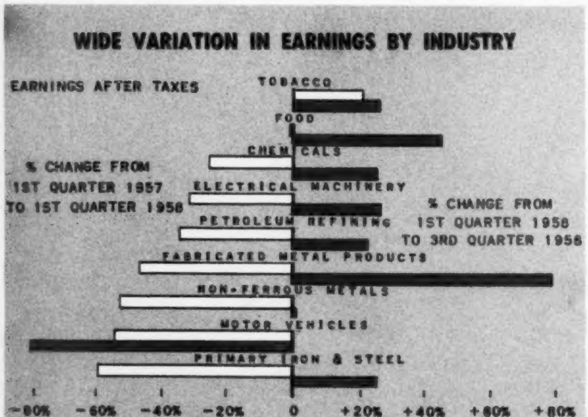
The decline and recovery of earnings spread through most industries. Among manufacturing corporations, post-tax earnings in durable goods lines fell 50% between first quarter 1957 and first quarter 1958. Earnings in nondurables declined 29% in the same period.

On the recovery side, nondurables earnings rose 36% from the first to the third quarters of 1958. Durables earnings were held down in the third quarter by an 80% lag on the part of the automobile companies. But early reports point to substantial gains in the fourth quarter.

Earnings and the Business Cycle

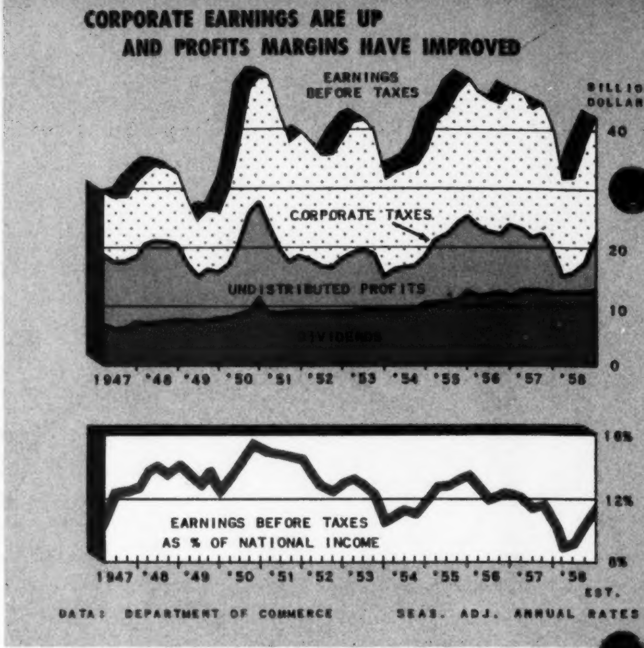
Typically, earnings fluctuate more widely than business as a whole both on the up and down sides of the business cycle. Moreover, the decline in earnings presaged the fall in general business activity in the current cycle. Corporate earnings actually reached their high towards the end of 1955 and held fairly stable for nearly two years. Then the steep drop came when the recession set in.

Why did profits peak out long before the recession began? The answer lies most importantly in divergent



trends in output and costs. From the end of 1955 to mid-1957, rising prices accounted for most of the increase in corporate sales. Real output, after adjusting dollar totals for higher prices, was practically stable. Since capacity was expanding, and costs per unit of output were rising, earnings tended to decline. In short, the failure of output to rise led to a squeeze on profit margins

At the bottom of the recession, profit margins were pushed lower than at any time in the postwar period—



they were actually one-third below the post-war average.

However, margins have improved dramatically in the past year. The various pressures imposed by recession led to a vigorous attack on costs and to a sharp improvement in operating efficiency.

Developments in manufacturing provide a case in point. Between April and November physical output rose 12% while man-hours worked increased only 6%. Thus output per man-hour—a measure of efficiency—rose at an annual rate of more than 10%.

While statistics on profit margins for the fourth quarter are not available as yet, it would appear that the ratio had recovered almost to the average level of the past five years. If such margins can be maintained, corporate earnings could possibly average $46-47 billion for the year 1959. This would mean a new record—but a level that could certainly be approached if the recovery in business continues and costs are held in line.

Dividends On a Steady Uptrend

Despite the widespread variations in earnings, dividend payments have increased steadily—from $6½ billion in 1947 to nearly $12¼ billion in 1958. During each of the three postwar recessions, dividends have been maintained in face of declining earnings. Thus, at the 1958 recession low, dividends were over 80% of post-tax earnings as against a 1947-57 average of 47%.

All in all, recent trends in earnings and dividends are encouraging. However, continued efforts to increase efficiency and hold costs under control will be necessary to maintain profit margins. Such efforts are important not only to stockholders but to the general public as well. To achieve balanced economic growth without inflation, corporate earnings must be high enough to support an expanding investment in new plants and equipment while costs must be held within the ability of the economy to pay them without raising prices.

PROGRESS REPORT ON EDUCATION

In the past twelve years, the number of students in all our schools has grown from 28 million to 43 million, or more than 50%. This unprecedented increase precipitated what has been termed "a crisis in education." How far have we come in dealing with this problem? Consider some highlights of our efforts during the postwar period:

- Outlays for the nation's schools last year added up to more than $20 billion—5½% of national income. This compares with $4 billion or just over 2% in 1945-46.

- Expenditures for school buildings have gone up at an even faster pace. In 1958 they totaled $3.4 billion or more than 15 times school construction in 1946.

- The average salary of public elementary and secondary school teachers in 1958 was $4,792. This is about 13% more than the average wage and salary earner received. Twelve years ago, teachers got 12% *less* than the average worker.

In short, the postwar period has witnessed a tremendous expansion in education.

Challenge to the Schools

At the end of the war, the educational system was confronted by a three-way challenge:

- The first was the unanticipated rate of population growth in the postwar years. The number of births rose from 2.6 million in 1940 (the kindergartners of 1946) to 4.4 million now.

- Then there was the ever-widening circle of those seeking education. Nine-tenths of the 14 to 17 year-olds are now in high school compared with seven-tenths in 1946. And 36% of the 18-21 age group are in college compared with 18% in 1946.

- Finally, there was the challenge of improving the quality of instruction at a time when the quantity demands were growing so rapidly.

These needs stimulated the rapid growth of the educational system in the postwar years. Expenditures during this period have been phenomenal. They have been estimated to total $150 billion over the twelve years. Even more significant, annual outlays increased five-fold during this time.

But perhaps the best measure of the effort which has supported the improvement in our schools is spending per pupil in constant dollars. Last year, $385 went to educate each pupil enrolled—double the pre-war peak even after adjustment for price changes. And, while much remains to be done, there have been notable advances in teaching methods, improvements in curricula, smaller classes and wider use of visual aids and TV.

Prospect

What lies ahead for the school system? One thing is clear. Despite the tremendous expansion of the postwar period, our educational problems are far from solved.

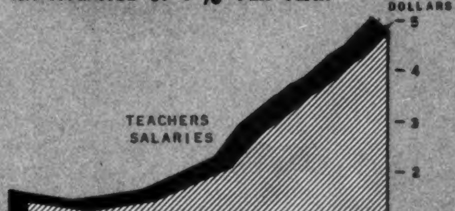
In the first place, school enrolments are still growing. By 1970, it is estimated, there will be 60 million students —17 million more than today.

But another factor complicates the problem of providing for these extra students. The age structure of the school population is changing. Although the crisis is passing for elementary schools, high schools are just beginning to feel the onslaught. And the question for the future is: "Will our colleges be adequate?" Estimates are that the number of high school students will increase 50% by 1969, and college enrolments could double by 1975.

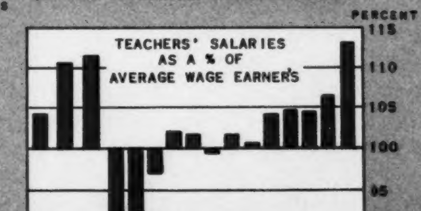
Providing for these students will take careful planning. One of the major problems will be to achieve high quality in the face of the overwhelming number of students. To this end efforts have already been set in motion to revise curricula and methods of teaching. For example, in the past two years 43% of all secondary schools revised their mathematics curriculum and 37% have changed their science courses.

In the final analysis, the major problem may be that of acquiring qualified teachers. Although salaries have been rising, teaching remains a relatively low-paid profession. In view of the importance of education in the rapidly changing world of today and tomorrow, efforts to elevate the status in the community of competent educators could make a significant contribution to our future growth and prosperity.

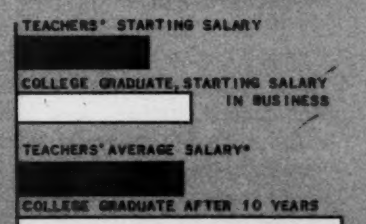
TEACHERS' SALARIES HAVE RISEN AN AVERAGE OF 7% PER YEAR



THE POSTWAR RISE OUTPACED THAT OF THE AVERAGE WAGE-EARNER

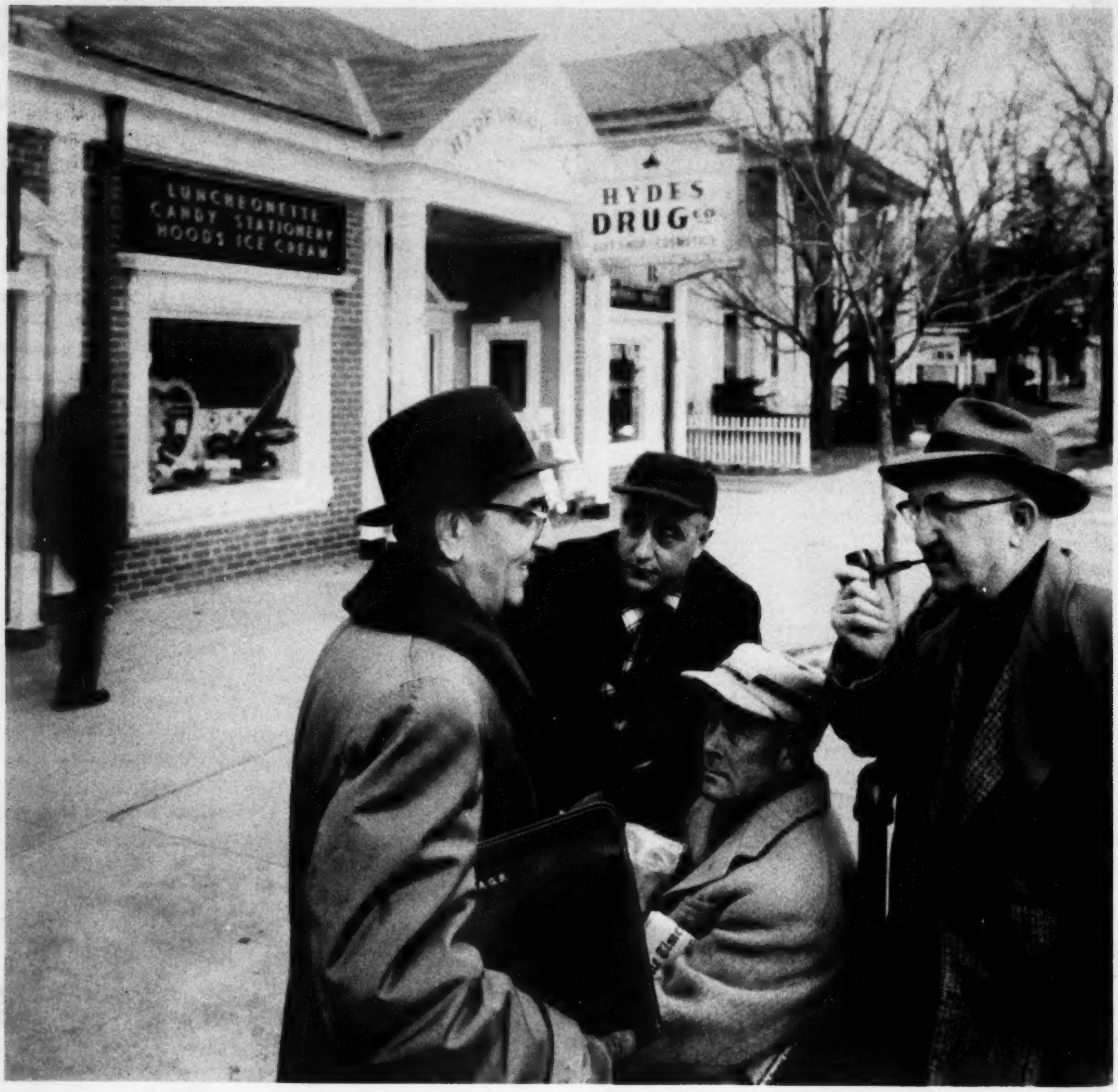


...BUT TEACHERS STILL EARN LESS THAN THE AVERAGE COLLEGE GRADUATE



DATA: NATIONAL EDUCATION ASSOCIATION, DEPARTMENT OF COMMERCE AND FRANK ENDICOTT

*12 YEARS EXPERIENCE



A banker talks . . .

Some noon hours he only listens.

But talking, or just taking things in, a banker gets to know what his neighbors think.

This is necessary because a banker has to know a community inside out before he can give it financial guidance, and put its idle money to work in wise and profitable ways.

So bankers live and work in the communities they serve. They share the ups and downs of home-grown economies. They lend a sympathetic ear to individual problems and offer advice or counsel when it is sought. And they willingly accept the civic leadership placed in their hands by neighbors.

Participating, talking and listening, bankers build progressively better banks. The net result is that commercial banking today solidly underpins the American way of doing business, and has the respect of the American people.

The Chase Manhattan Bank is proud to represent and provide banking service in New York for more than 3,900 banks in towns, villages and cities from coast to coast.

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